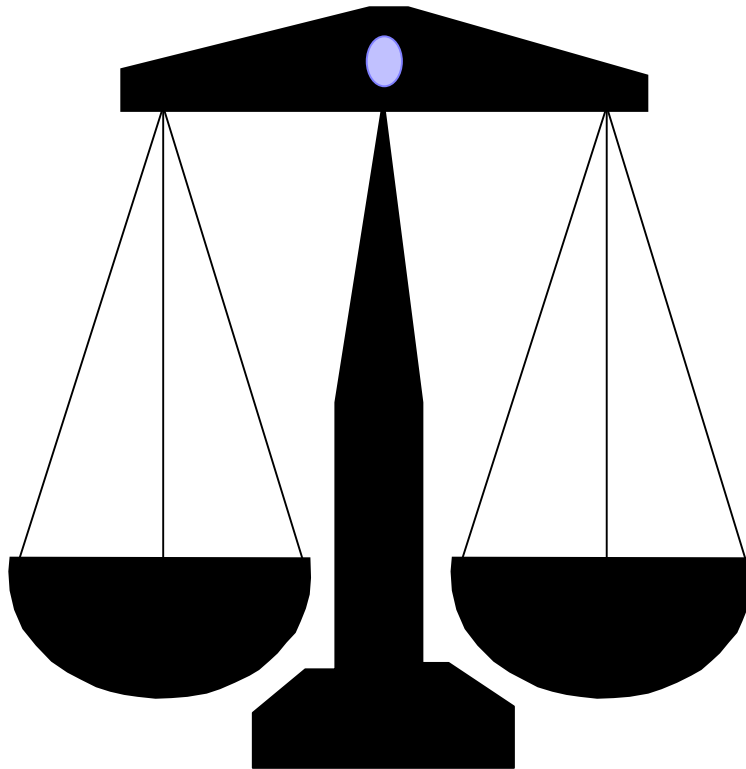


**The Application of State Law to "On-Us" Check-  
Cashing Fees**



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An "on-us" check is one that is drawn on the bank or other financial institution where it is presented for payment. Some banks have started charging a fee in order to receive payment for such checks if the payee does not have an account with the bank. If a holder in due course does not receive the full value of a check for this reason, the question arises as to whether or not the bank has wrongfully dishonored the check.

Indiana statutes are silent on this issue as presented. It is therefore necessary to examine the existing statutory construct to determine a proper response. IC 26-1-4-106 states that an item, such as a personal check, is payable at a bank identified in the item if two requirements are met. First, it must designate the bank as a collecting bank without itself authorizing the bank to pay the item. Second, it may be presented for payment only by or through the bank in question. An on-us check meets these two requirements.

IC 26-1-3.1-502 refers to the dishonor of a negotiable instrument. Personal checks are governed by the rules set forth in subsection (b) for dishonor of an unaccepted draft other than a documentary draft. IC 26-1-3.1-502(b)(2) states, "If a draft is payable on demand...the draft is dishonored if presentment for payment is duly made to the drawee and the draft is not paid on the day of presentment." This implies that a bank that refuses to make payment on an on-us check, without the payment of a fee by non-customers, dishonors said check.

If the check is dishonored or returned unpaid for any reason, under IC 26-1-3.1-502.5 the holder may charge and collect from the maker of the check up to twenty dollars plus an amount equal to the charge by the bank for the dishonored instrument. The implication is that the dishonor of a valid check by the bank leads to liability for the account-holder for not only the amount in question, but also an additional twenty-dollar charge.

So long as the payee is a holder in due course, a depository institution is obligated to make payment on a check drawn at that institution. A holder in due course is defined in IC 26-1-3.1-302(a)(1) as the holder of a negotiable instrument that "...does not bear such apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity." In addition the holder must have taken the instrument for value, in good faith, without notice that it has been dishonored or that there is an uncured default with respect to payment, without notice that it contains an

unauthorized signature or has been altered, without notice of any claim to the instrument described in IC 26-1-3.1-306, and without notice that any party has a defense or claim in recoupment described in IC 26-1-3.1-305(a). IC 26-1-3.1-302(a)(2). An on-us check will generally meet these requirements, thus leading to a holder in due course.

A holder in due course is entitled to payment so long as adequate presentment is made. The rules for presentment are set forth in IC 26-1-3.1-501, and nowhere in this section is it even implied that any charge can be levied without wrongfully dishonoring the negotiable instrument. The party to whom presentment is made may only return the instrument for lack of a necessary endorsement or refuse payment for failure to comply with the terms of the instrument, an agreement of the parties, or other applicable law or rule. IC 26-1-3.1-501(b)(3). There exists no other applicable law which would allow for the dishonor of a properly presented check simply because the holder in due course is not an account-holder at the institution involved. Furthermore, charging a fee before honoring an on-us check is not authorized by any statute in the Indiana Code. "If tender of payment of an obligation to pay an instrument is made to a person entitled to enforce the instrument, the effect of tender is governed by principles of law applicable to tender of payment under a simple contract." IC 26-1-3.1-603.

While there is no express authorization of such charges, neither is there any express rejection of them. There is no mention of charges imposed on non-customers. Even case law on this issue is scarce, but there is some indication of the direction courts might take. The Appellate Court of Illinois has held that the deduction of a service fee before the balance of the face amount of the check is paid, adequately supports an allegation of dishonor.<sup>1</sup> It stated, "[A bank has] the option of paying the full face amount...or to refuse payment of the full face amount and risk a charge of 'dishonor'".<sup>2</sup> A service fee cannot be justified to offset a nonexistent risk if there is no question as to the identity of the person presenting the check for payment.<sup>3</sup>

To hold otherwise would be a failure to follow the purposes of the Illinois Commercial Code<sup>4</sup>, which is similar in most aspects to Indiana's. The main focus of this case,

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<sup>1</sup> *Your Style Publications, Inc. v. Mid Town Bank and Trust Company of Chicago*, 501 N.E.2d 805.

<sup>2</sup> *Id.*, at 808.

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*, at 809.

however, was to hold that the plaintiffs had stated a cause of action that could survive a motion for dismissal. The court reversed and remanded, and the matter was subsequently settled out of court. Since that time, the Illinois Office of Banks and Real Estate's policy has been that in order to avoid the possible application of Your Style Publications, financial institutions can come to an agreement with their customers permitting the institution to charge the customers a fee for the payment of an on-us check to a non-customer. Under no circumstances, however, should such a charge be levied against a non-customer who is a holder in due course and whose identity is not in question without there being some question of a wrongful dishonor for failure to pay the face amount of the check.

Analogous case law also implies that such charges applied to a holder in due course results in the wrongful dishonor of the instrument by refusing payment of the full amount. In a Missouri case where a money order was accepted in payment for services, the payee of the instrument became a holder in due course. As such, he was entitled to payment upon presentment of the order. The defendant in this case, who presented no evidence to refute the status of the holder in due course, wrongfully dishonored the instrument by refusing payment.<sup>5</sup> The fact pattern of this case parallels that found with on-us checks.

Furthermore, Indiana case law makes it clear that an action against a bank for constructive fraud in these transactions can be sustained. The Indiana Court of Appeals held that the relationship between a bank and a checking account holder is sufficient to support inference of fraud.<sup>6</sup> A checking account is a contract for the deposit of funds between the depositor and the financial institution. Any representation made by a bank when an account is opened that the bank will honor checks drawn on the account in the future are representations regarding future conduct. Such a representation, in some situations, gives rise to a constructive fraud.<sup>7</sup> The court here stated:

"...[T]he relationship invokes a duty of good faith and fair dealing to at least the same extent as does a buyer-seller relationship. A bank is inherently in a position superior to its checking

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<sup>5</sup> Lovejoy v. Weese, 689 S.W.2d 387, 388 (Mo.Ct.App. 1985).

<sup>6</sup> Wells v. Stone City Bank, 691 N.E.2d 1246 (Ind.App. 1998).

<sup>7</sup> Id., at 1250, citing Farrington v. Allsop, 670 N.E.2d 106, 109 (Ind.App. 1996).

account holders, who, in order to conduct their business, must depend on the bank to protect the account holder's funds and to honor checks on the account holder's account when they are **properly presented for payment**. The bank and account holder relationship, like the buyer and seller relationship, is sufficient to support an inference of fraud..."<sup>8</sup>

The bank's representation that it would honor the account-holder's checks and the subsequent wrongful dishonor of those checks are a representation or omission in violation of the bank's duty.<sup>9</sup> When a bank wrongfully dishonors a customer's check, there arises a presumption that the customer's credit and business standing has been harmed.<sup>10</sup>

It was also alleged that the bank gained an advantage at the account-holder's expense by creating a sham transaction that generated interest income for the bank with no benefit to the account-holder.<sup>11</sup> The same reasoning would apply to a charge levied on the cashing of on-us checks. Through a wrongful dishonor, the bank gains additional income with no benefit to the account-holder as well as opening the account-holder up to liability for the dishonor of that check. The bank should not be able to shift its burden to the payee for restitution by engaging in constructive fraud. Based on the statutory limitations and applicable case law, a fee levied against non-customers, who can adequately identify themselves as holders in due course, amounts to a wrongful dishonor in violation of Indiana law.

Nonetheless, federal regulators view these transactions differently. The OCC interpretation is that national banks have the authority to assess non-interest charges and fees on its customers. This position states that it "...is a business decision to be made by each bank, in its discretion, according to sound banking judgment and safe and sound banking principles."<sup>12</sup> In keeping with its position on ATM surcharges, the OCC views the term "customer" in this regulation as meaning any party that obtains a product or service from the bank. Such a viewpoint leads to the conclusion that those wishing to cash an on-us check are "customers" and therefore subject

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<sup>8</sup> *Id.*, at 1251. (emphasis added)

<sup>9</sup> *Id.*

<sup>10</sup> *First Nat. Bank of New Castle v. Acra*, 462 N.E.2d 1345.

<sup>11</sup> *Wells*, at 1251.

<sup>12</sup> 12 CFR 7.4002(b).

to any fees that may be charged by a bank according to "sound banking judgment and safe and sound banking principles".

This issue is still undecided nationally, and is currently under review by the federal courts. With this in mind, it is still prudent for Indiana regulators to form an opinion based on Indiana law pending a resolution on the federal level. Based on the statutory provisions in the Indiana Code and the available case law, a fee charged to a holder in due course is a wrongful dishonor and should not be assessed by any financial institution operating under a state charter.